

If the activities of the partnership have advanced to the extent necessary to establish the nature of its business operations, it will be deemed to have begun business. Accordingly, the acquisition of operating assets which are necessary to the type of business contemplated may constitute beginning business for these purposes. The term *operating assets*, as used herein, means assets that are in a state of readiness to be placed in service within a reasonable period following their acquisition.

[T.D. 7891, 48 FR 20049, May 4, 1983]

CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

CONTRIBUTIONS TO A PARTNERSHIP

§ 1.721-1 Nonrecognition of gain or loss on contribution.

(a) No gain or loss shall be recognized either to the partnership or to any of its partners upon a contribution of property, including installment obligations, to the partnership in exchange for a partnership interest. This rule applies whether the contribution is made to a partnership in the process of formation or to a partnership which is already formed and operating. Section 721 shall not apply to a transaction between a partnership and a partner not acting in his capacity as a partner since such a transaction is governed by section 707. Rather than contributing property to a partnership, a partner may sell property to the partnership or may retain the ownership of property and allow the partnership to use it. In all cases, the substance of the transaction will govern, rather than its form. See paragraph (c)(3) of § 1.731-1. Thus, if the transfer of property by the partner to the partnership results in the receipt by the partner of money or other consideration, including a promissory obligation fixed in amount and time for payment, the transaction will be treated as a sale or exchange under section 707 rather than as a contribution under section 721. For the rules governing the treatment of liabilities to which contributed property is subject, see section 752 and § 1.752-1.

(b)(1) Normally, under local law, each partner is entitled to be repaid his contributions of money or other property

to the partnership (at the value placed upon such property by the partnership at the time of the contribution) whether made at the formation of the partnership or subsequent thereto. To the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share in partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), section 721 does not apply. The value of an interest in such partnership capital so transferred to a partner as compensation for services constitutes income to the partner under section 61. The amount of such income is the fair market value of the interest in capital so transferred, either at the time the transfer is made for past services, or at the time the services have been rendered where the transfer is conditioned on the completion of the transferee's future services. The time when such income is realized depends on all the facts and circumstances, including any substantial restrictions or conditions on the compensated partner's right to withdraw or otherwise dispose of such interest. To the extent that an interest in capital representing compensation for services rendered by the decedent prior to his death is transferred after his death to the decedent's successor in interest, the fair market value of such interest is income in respect of a decedent under section 691.

(2) To the extent that the value of such interest is: (i) Compensation for services rendered to the partnership, it is a guaranteed payment for services under section 707(c); (ii) compensation for services rendered to a partner, it is not deductible by the partnership, but is deductible only by such partner to the extent allowable under this chapter.

(c) *Underwritings of partnership interests*—(1) *In general.* For the purpose of section 721, if a person acquires a partnership interest from an underwriter in exchange for cash in a qualified underwriting transaction, the person who acquires the partnership interest is treated as transferring cash directly to the partnership in exchange for the partnership interest and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a

partnership issues partnership interests for cash in an underwriting in which either the underwriter is an agent of the partnership or the underwriter's ownership of the partnership interests is transitory.

(2) *Effective date.* This paragraph (c) is effective for qualified underwriting transactions occurring on or after May 1, 1996.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8665, 61 FR 19189, May 1, 1996]

§ 1.722-1 Basis of contributing partner's interest.

The basis to a partner of a partnership interest acquired by a contribution of property, including money, to the partnership shall be the amount of money contributed plus the adjusted basis at the time of contribution of any property contributed. If the acquisition of an interest in partnership capital results in taxable income to a partner, such income shall constitute an addition to the basis of the partner's interest. See paragraph (b) of § 1.721-1. If the contributed property is subject to indebtedness or if liabilities of the partner are assumed by the partnership, the basis of the contributing partner's interest shall be reduced by the portion of the indebtedness assumed by the other partners, since the partnership's assumption of his indebtedness is treated as a distribution of money to the partner. Conversely, the assumption by the other partners of a portion of the contributor's indebtedness is treated as a contribution of money by them. See section 752 and § 1.752-1. The provisions of this section may be illustrated by the following examples:

Example 1. A acquired a 20-percent interest in a partnership by contributing property. At the time of A's contribution, the property had a fair market value of \$10,000, an adjusted basis to A of \$4,000, and was subject to a mortgage of \$2,000. Payment of the mortgage was assumed by the partnership. The basis of A's interest in the partnership is \$2,400, computed as follows:

Adjusted basis to A of property contributed	\$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80 percent of \$2,000)	1,600
Basis of A's interest	2,400

Example 2. If, in example 1 of this section, the property contributed by A was subject to a mortgage of \$6,000, the basis of A's interest would be zero, computed as follows:

Adjusted basis to A of property contributed	\$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80 percent of \$6,000)	4,800
	(800)

Since A's basis cannot be less than zero, the \$800 in excess of basis, which is considered as a distribution of money under section 752(b), is treated as capital gain from the sale or exchange or a partnership interest. See section 731(a).

§ 1.723-1 Basis of property contributed to partnership.

The basis to the partnership of property contributed to it by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution. Since such property has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. See section 1223(2). For elective adjustments to the basis of partnership property arising from distributions or transfers of partnership interests, see sections 732(d), 734(b), and 743(b).

DISTRIBUTIONS BY A PARTNERSHIP

§ 1.731-1 Extent of recognition of gain or loss on distribution.

(a) *Recognition of gain or loss to partner—(1) Recognition of gain.* (i) Where money is distributed by a partnership to a partner, no gain shall be recognized to the partner except to the extent that the amount of money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. This rule is applicable both to current distributions (i.e., distributions other than in liquidation of an entire interest) and to distributions in liquidation of a partner's entire interest in a partnership. Thus, if a partner with a basis for his interest of \$10,000 receives a distribution of cash of \$8,000 and property with a fair market value of \$3,000, no gain is recognized to him. If \$11,000 cash were distributed, gain would be recognized to the extent of \$1,000. No